SUPPORTERS OF THOMAS FSC BILL REACH OUT TO MANZULLO TO GET SUPPORT

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House Ways and Means Committee Chairman Bill Thomas (R-CA) is reaching out to House Small Business Committee Chairman Don Manzullo (R-IL) in an effort to devise a new bill to repeal the foreign sales corporation and its successor tax provisions that could pass the House. This effort comes after an offer of adding new subsidies for tobacco farmers to the bill failed to attract more support from House Democrats and Republicans in tobacco states, sources said.

Rep. Jim McCrery (R-LA), a Ways and Means member, met with Manzullo on May 20 in an effort to seek his support for the new bill now being crafted, and Manzullo presented McGrery with "some suggestions" for a new FSC-ETI repeal bill, according to a Manzullo spokesman.

The spokesman did not specify what changes Manzullo seeks, but other sources said he is particularly interested in extending the cut in the corporate tax rate to so-called S-corporations, which are generally smaller than C-corporations, and to apply it on a product line by product line basis.

Both of these changes would drive up the cost of the Thomas bill, whose pending version approved by Ways & Means limits the tax rate cut to C-corporations and would apply it to a company's total eligible income. Up to now, Thomas has rejected the product line option as too expensive, and one House Republican aide said that provision would drive up the cost of the Thomas bill by as much as $30 billion over 10 years (*Inside U.S. Trade,* Jan. 16, 2004).

Manzullo's staff has also met with Ways and Means tax staff on four occasions in the last two weeks, according to the Manzullo spokesman. The chairman is "encouraged by the dialogue" that is taking place and is committed to working with the House leadership to pass a FSC-ETI repeal bill that would "retain and create jobs in America," the spokesman said.

One lobbyist said Thomas's effort to win the support of Manzullo and his allies in the House may be his "last option," but that he may be at a point where he will make that effort to be able to pass a bill to repeal FSC and its successor regime, the Extraterritorial Income Act. Late last year, 22 House Republicans expressed their opposition to the Thomas bill by signing a letter initiated by Manzullo, but informed sources said not all of them are as strongly opposed as Manzullo (*Inside U.S. Trade*, Nov. 7; Oct. 31, 2003).

As he tries to attract these votes, Thomas also must curtail the cost of the bill to avoid losing other Republican votes, a point sources said was made by McCrery to a business group last week.

Another complication is Thomas's objection to a number of policy changes the Senate made to pay for its version of the FSC-ETI repeal bill, which the Joint Committee on Taxation estimates to cost $167.3 billion over 10 years, sources said. McCrery told the business group that includes changes to the tax code that make it harder for municipalities to strike leasing arrangements with corporations to cover the costs of infrastructure projects, sources said. Thomas objects to completely ending this practice, which provides cities with a source of funding, without offering them an alternative (*Inside U.S. Trade*, March 19, 2004).

McCrery also said Thomas objects to the Senate bill's limits on tax shelters set by putting into law the so-called economic

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substance doctrine. The economic substance doctrine as interpreted by a U.S. court says that a transaction conducted solely for its tax benefits is ineligible for a tax deduction, private-sector sources said. The Senate provision on the economic substance doctrine raises about $13.3 billion over ten years, according to the latest assessment offered by the Joint Committee on Taxation.

Another Thomas problem with the Senate bill McCrery identified is the retroactive application of some of the revenue raising provisions, these sources said.

Demands for including various other tax provisions are bound to be plentiful as the FSC-ETI repeal bill is perceived as the only tax bill moving forward this year, one lobbyist said. One option that Republican supporters of the bill have already floated is the extension of certain expiring energy tax provisions, although they have made it very clear that Thomas is not willing to include all the energy tax provisions in the Senate bill wholesale, sources said.

Another possible addition is the so-called bonus depreciation language that would allow businesses to write off the cost of capital equipment or investment by 50 percent in the first year, followed by a much faster depreciation than current law allows, business sources said. The Senate included a limited bonus depreciation rule for corporate aircraft excluding those used in the transportation industry, which costs as much as $519 billion during 2004-2008, according to an assessment by the Joint Committee on Taxation.

In response to questions from business representatives at a public meeting earlier this month, Thomas refused to answer whether he would include this provision, private-sector sources said. But some of them speculate that he is considering its inclusion, which can be explained as an economic stimulus effort.

In light of this situation, some sources are expressing doubt whether the House would approve a bill before the July 4 recess, as Thomas and members of the House leadership said this month. They also point out that a Ways and Means tax aide told a business group last week that there is no timeframe or schedule for moving on a FSC-ETI repeal bill.

Manzullo has been most critical of the international provisions of the Thomas bill, but supporters hope that some of that criticism can be diminished by the fact that the Senate voted overwhelmingly for a strong package of international provisions. But the Senate's version differs from a pending version of the Thomas bill approved by Ways and Means last year in such areas as easing the rules for foreign tax credits. Such tax credits allow companies to offset U.S. tax obligations with foreign taxes they have already paid.

The Senate made it easier to use foreign tax credits by extending the time in which they can be used from five to 20 years at a cost of about $6.5 billion over 10 years. In contrast, the committee-passed Thomas bill would simplify the foreign tax credit system by reducing the number of income baskets from nine to two, at a cost of about $8.2 billion over ten years. Thomas earlier this month implied it may be hard to resolve these different policy approaches even though their costs are not vastly different.

Under the current tax credit system, companies have to divide income into different baskets. They then can use foreign taxes paid on income in a particular basket to offset U.S. taxes on income in that same basket. By reducing the number of baskets, companies gain flexibility in their use of tax credits, so that they could offset taxes paid on manufacturing income with taxes owned on financial services income, sources said. [END]